

NEWS ALERT**BUSINESS GROUP****Coronavirus & Material Adverse Change Clauses in M&A Deals**

By Mark J. Tarallo & Sergio E. Marin | March 16, 2020

The coronavirus (COVID-19) global pandemic continues to dominate worldwide news cycles, and will likely do so for the foreseeable future. Parties to business transactions might be left wondering how the coronavirus and resulting uncertainty could impact a potential or current M&A transaction. For example, what if the target in a pending transaction has or will suffer financial losses as a result of the coronavirus? The parties, and especially a buyer, might ask themselves if there is a way out of the transaction. In particular, parties might wonder if a buyer in an M&A deal can back out of the deal using a material adverse change (MAC) clause coronavirus outbreak.

What is a “Material Adverse Change” Provision?

A material adverse change clause, sometimes called a “material adverse effect,” or MAE clause, is a clause in a transaction document that allows a party to back out of a transaction if there is a change in circumstances that significantly reduces the value of the target company. It typically covers the period between the signing of the transaction agreement and the closing of the transaction. Normally, the language in these clauses, and related exclusions, qualifications, and limitations, are heavily negotiated between the parties. However, rarely do the parties define in any specific language what exactly constitutes a material adverse change. As a result, it is left to the courts to use a fact-based inquiry to determine whether a material adverse change has occurred.

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Courts have traditionally been reluctant to find that a buyer can walk away from a transaction due to a material adverse change unless a buyer can show the target suffered a significant and long-term impact. Under most case law, a party arguing that a material adverse change occurred must show more than a short-term adverse effect on the financial condition of the target company. The party arguing for the application of the material adverse change provision must show that the adverse change substantially threatens the overall earning potential of the target company in a durationally-significant matter.

For instance, the Delaware Court of Chancery has noted that the adverse change or effect must be material in the long-term and that the important consideration is “whether there has been an adverse change in the target’s business that is consequential to the company’s long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months.” *Akorn, Inc., v. Fresenius Kabi AG, et al.*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018).

Could the coronavirus outbreak trigger a MAC?

At the present time, it is unlikely a party can use adverse changes resulting from coronavirus as a reason to walk away from a deal, but any analysis will depend heavily on the specific language at issue and the relevant facts. Often, parties will exclude general economic events, epidemics and other natural disasters from the definition of material adverse change (reflecting an intention that MACs be narrowly construed). As the World Health Organization declared the coronavirus a pandemic on March 11, 2020, it would likely fall into that sort of exception to the definition of material adverse change.

Even if the parties did not explicitly exclude events like the coronavirus from the definition of material adverse change, it will likely be difficult to use the coronavirus as a basis for terminating a transaction. The long-term effects of the coronavirus on most businesses are unknown and therefore it would be difficult to convince a court that the coronavirus substantially threatens the overall earning potential of the target company in a durationally-significant manner. The outbreak might cause financial distress to the target company now, and perhaps the parties can predict a downturn in the next several months with some certainty. Despite that, most of the current case law requires that the party show that the downturn will be consequential over a period of years.

What steps can a client take now?

If a party is concerned about how the coronavirus outbreak could impact a potential or current transaction, they should first review the language of their documents with their legal counsel to determine if there are any specific exclusions to the definition of material adverse change. The next step would be to perform a fact-based inquiry of how the coronavirus outbreak has impacted the business and how it would affect the target company in the long-term. Moreover, both parties should be sure to maintain accurate records and data demonstrating the financial impact caused by the coronavirus outbreak.

If you have questions about how the coronavirus outbreak affects your business, please do not hesitate to contact us.